

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

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by the Staff

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SUMMARY*Outlook and Overview

The outlook seems considerably brighter compared to the December Redbook. Most Districts report definite signs of improvement in economic activity, or at least judge that improvement is imminent. Least optimistic are Richmond and Dallas (both reported "little change" recently), Cleveland ("the bottom may be near") and Kansas City ("recovery to get underway during the second or third quarter"). Retail sales (ex-autos) are brisk and expected to remain strong in most Districts. Sales of domestic automobiles, especially large models, are improved. Manufacturing activity is mixed, with improved orders from the automotive, electronics and housing sectors, while only the business equipment sector continues to decline. Inventories appear to have fallen to desired levels in most sectors. While further declines are more likely than increases, there is no indication that declines would be sharp. Residential construction continues to improve as sales of new and pre-owned homes have been boosted by mortgage interest rate declines. Agriculture remains a weak spot with farm income down and many farmers in financial difficulty. Bank lending activity is generally flat; business loans are expected to stay flat while consumer loans are expected to improve.

Consumer Spending

Retail sales (ex-autos) in most Districts are brisk and are expected to remain strong. January department store sales were especially good in Philadelphia ("off to a flying start") and in Cleveland ("a fundamental upswing in demand"). Exceptions were Kansas City, Dallas, and San Francisco,

*Prepared at the Federal Reserve Bank of Cleveland.

where either sales showed less strength or retailers were cautious about the outlook. Sales of non-auto consumer durables were generally weak except in Atlanta, where they have been spurred by a resurgence in housing. Some Districts report retail sales have benefited from unseasonably warm weather, but Chicago reports warm weather has hurt apparel sales.

Automobile sales, especially of large domestic models, are improved in most Districts. Dallas reports sales of imported cars remain low. Atlanta notes that sales have been assisted by exceptionally low financing rates ("5.9-6.9 percent and even as low as 2.9 percent").

Manufacturing and Mining Activity

Industrial activity is mixed, suggesting that a trough may have been reached. Most Districts report orders and activity up at some firms but down at others. Orders have improved for automobiles and trucks, defense and consumer electronics, and products to construct and furnish new houses. Some improvement in orders for steel are reported but steel plant shutdowns continue to be announced. Mining continues very weak, with additional mine shutdowns reported. Business equipment manufacturing is probably the weakest sector, with additional declines in sales and production expected for 1983.

Inventories

Inventories seem to have fallen to desired levels in most sectors, but declines remain more likely than increases. Retail inventories are lean and at desired levels almost everywhere but there is little sentiment for increasing them. Some manufacturers continued to cut inventories in January while others had already reached their desired inventory levels. Few manufacturers plan to build inventories, even those with rising orders. Inventories of oil drilling supplies remain excessive, and Richmond reports many manufacturers' inventories are well above desired levels.

Construction and Real Estate

Residential construction continues to improve. Most Districts report sales of new and pre-owned homes have been spurred by declines in mortgage interest rates, and permit issuance and housing starts have increased. Exceptions are Southern California, where the unsold inventory is still large; Philadelphia, where "housing starts remain stalled and new home prices continue to drop;" and Richmond, where the pace of the housing recovery has moderated in recent weeks. Chicago reports house construction has benefited from unusually mild weather.

There are scattered reports of improvement in non-residential construction, but Chicago expects a downturn.

Agriculture

Farmers continue under pressure. Farm income has fallen in several Districts and farmers are reported having difficulty repaying loans. Chicago reports agricultural land prices 20 percent below their late-1970s peak. The payment-in-kind or crop-swap program is expected to achieve a high farmer participation rate in several Districts, reducing production expenses in 1983 and increasing crop prices in 1984. Suppliers of seeds, fertilizer, pesticides, and fuel are expected to be hurt by the program.

Finance

Bank lending activity is mixed. Several Districts describe business loan demand as relatively flat, with little growth expected in the next few months. Consumer loan demand, commented on by only three Districts, is flat or up slightly, with near-term growth expected as consumer optimism improves. Minneapolis reports demand for new agricultural credit is low but demand for farm debt refinancing is greater than normal. Demand for mortgage loans is

reported up in a few Districts, and the 30-year fixed rate loan is the most popular. Conventional mortgage rates edged up in January in Atlanta.

The new deposit accounts differ sharply in popularity. The money market deposit account (MMDA) has been marketed aggressively and has achieved rapid growth. Atlanta reports very little attrition from these accounts following expiration of bonus interest rates. Estimates of the share of MMDA deposits that are "new" money to the institution range from 15 to 60 percent. Public response to the Super NOW account seems to be uniformly unenthusiastic. Kansas City attributes the apathetic response to weak promotion, consumer confusion, and MMDA competitive superiority because of higher yields and lower service charges.

FIRST DISTRICT - BOSTON

Reports from First District businesses were generally more positive than they have been in some months. The change was particularly marked among manufacturers. At the time of the last Red book survey, none of the manufacturers contacted saw any evidence of a recovery; however, several now report a definite pickup in orders, while others describe conditions as "a little better". For some firms, there has been no improvement; but among those contacted, even these have no immediate plans for layoffs. Reports from the retail sector are mixed, with the Christmas season described as both "outstanding" and "disappointing". Retail inventories are said to be lean.

Retailing

Retailers in the First District gave mixed reports on sales in the Christmas season. Comparison shopping and competitive pressures increased the importance of promotional activity, with some adverse effects on profit margins. Inventories are generally at satisfactory levels.

One department store in southern New England expressed disappointment at five percent sales growth in December; widespread discounting reduced gross margins. A medium-price chain reported 9 percent growth for its New England stores in December, a considerably better performance than their stores elsewhere in the nation. An appliance and audio-video electronics chain in the Boston area had an "outstanding high-teens" increase over last year's sales and an even greater growth in profits. The stores with the "outstanding" and "disappointing" sales both

attributed their results to careful comparison shopping. Store results were fairly uniform across product lines, although sales of television and video-related products and kerosene heaters were especially strong. Sales were more concentrated in the last few days before Christmas than they were in previous years.

Inventories are lean, and goods are reported to be available as needed from suppliers. Merchants say they are planning for a continuation of their own recent performance over the next half year, and are stocking accordingly.

Manufacturing

In marked contrast to last month when no one saw any sign of an upturn, three or four manufacturers report significant increases in orders. Several others report that the decline has stopped and that orders appear to be a little stronger, but the improvement is too small to be interpreted as evidence of a recovery. A few firms see no change for the better and even further declines in orders and backlogs. A similar pattern is apparent in a recent survey of New England purchasing agents. About half of the purchasing agents reported that orders and backlogs did not change in December; however, for the first time in over a year more agents reported that orders and backlogs increased in the month than reported decreases.

Among the firms contacted, the most encouraging report came from a manufacturer of castings. A spurt in activity in a variety of areas - defense, automotive and sporting goods - has caused this firm to revise upwards its profit estimates for 1983 three times. A manufacturer of home

furnishings has seen a pickup in orders for carpeting; previously this product was described as a "disaster area". Sales for furniture and other housing-related products also seem to be improving. The other firms reporting an upturn in sales were machine tool firms, for which the auto industry is the largest customer.

Firms in which there appears to have been a slight improvement, but one too weak to be considered evidence of a recovery, include manufacturers of energy-related capital goods, printing supplies, replacement auto parts, and optical instruments. Firms which reported no improvement or further declines were a supplier of precision materials to basic industries and a machine tool manufacturer.

The firms contacted were generally satisfied with their inventory levels; they described their customers' inventories as very low and one machine tool maker reported that buyers have started to request rapid delivery. Most firms do not plan any more layoffs and two of the firms reporting an upturn have cautiously started to rehire people. The one auto assembly plant in New England has recalled half its workforce.

Several firms emphasized how "lean and mean" they had become. They expect to enjoy good profits when the recovery gets underway; however, there is an awareness that other firms are also mean and lean and that caution in building inventories and rehiring workers will slow the recovery. All those contacted expect the recovery to be modest. However, several of the firms reporting at least a faint pickup in activity are capital goods producers and had previously said they did not expect a recovery in their own operations until the second half of 1983 or later.

Professors Eckstein and Houthakker were available for comment this month. Professor Eckstein believes the recovery has begun. But the recovery will be weak because, however strongly the other components of GNP grow, sluggish investment spending, state and local government outlays, and net exports will restrain overall growth. This recovery, unlike other postwar recoveries, will not rekindle inflation, stirring our fears of a runaway boom. Both this year and next, Eckstein expects inflation to average about 5.5 percent. "The recovery deserves to be nursed." He "can't argue for a large decline in short-term interest rates, but bond rates are much too high." With low inflation bond yields should fall, but the problem is to "sustain the recovery with a reasonable management of the aggregates to avoid frightening the credit markets."

Houthakker has no complaints so far about the course of monetary policy. He suggests that the Fed might use some measure of credit as a guide for policy until M1's adjustments are complete. Houthakker too believes the recovery is at hand: "fourth quarter final sales were the highest of any quarter in 1982 -- the increase in final sales is more important than the decline in GNP." Despite December's favorable CPI report ("a fluke"), there appear to be no signs of improvement in the inflation rate, and one must look very hard to see much improvement in the rate of wage increases. Houthakker expects that unit labor costs will rise 2 or 3 percent in 1983. As a result, inflation could average 3 percent next year, but 1983's fourth quarter inflation rate may rise to 4 percent.

SECOND DISTRICT--NEW YORK

In recent weeks, the Second District economy showed a few more signs of improvement, suggesting it has hit bottom and is beginning to turn up. The retail sector experienced moderate gains in December, and January sales substantially outpaced the year-ago level. Lower mortgage rates stimulated home sales and builders were fairly optimistic about prospects for the spring. Some new nonresidential construction projects got underway even though the office market remained soft. Manufacturing continued to be generally depressed, but business leaders found some indications that activity in that sector may be starting to pick up. In sum, the outlook has brightened somewhat.

Consumer Spending

Retailers finished December with stronger-than-expected sales, and the gains continued into the new year. Heavy promotional efforts helped boost January's volume substantially over the level of a year ago, when inclement weather severely depressed activity. Apparel, housewares, and consumer electronics all moved well, but big-ticket items like furniture still attracted little attention. Inventories were generally at desired levels for most stores. Merchants were somewhat cautious about the outlook, but some had increased their buying plans modestly in anticipation of gains in the spring.

Construction and Real Estate Activity

Additional signs of recovery appeared in the residential real estate market. Sales at several large condominium projects were spurred by lower mortgage rates, as were the sales of existing homes. Citing a recent increase

in the size of mortgages eligible for Federal insurance, developers announced plans to construct a large luxury rental building in Manhattan. The increased eligibility was also expected to make possible the construction of some long-planned residential complexes which had experienced financing difficulties. District builders were fairly optimistic about the months ahead.

The nonresidential real estate market also improved. Despite continuing softness in the office market, ground was broken for two new office towers, one in downtown New York City and one in Westchester County. Developers announced plans for other office and mixed use projects, although no starting dates have been set. In addition, construction was reported underway on a new resort development in one upstate New York community and plans for another are under discussion. Brokers did not report an increase in leasing activity but were hopeful that a pickup would materialize soon.

Business Activity

Although the manufacturing sector generally continued to operate at a very low level, business leaders observed a number of signs that activity may be starting to pick up. Several of our contacts were encouraged by the recalls of automotive workers around the District. Tool and die producers were reported to be receiving a rising number of requests for bids. In other industries such as instruments and ball bearings, expanding production at some firms offset small workforce or pay cuts by others. While the planned shutdown of a major steel facility in one area threatened to send the local unemployment rate up sharply, plants in other parts of the District were being kept open by the transfer of ownership to local management groups or foreign companies. The nonmanufacturing sector continued to hold up well. In Buffalo, which has been particularly hard-hit by the slump in manufacturing,

the financial and business services industries were doing quite well due to the area's growth as a regional banking center.

Outlook

Business leaders have begun to sense that the economy has finally hit bottom and are now hopeful that the recovery will get underway during the second quarter. One source of the rising optimism was an increase in average weekly hours in most of the District. Our respondents generally believe that longer workweeks will be followed two or three months from now by increases in employment. However, one employment official who forecast an upswing also expressed concern that the recovery could be weak and short-lived. As for capital spending, none of our contacts saw an imminent rebound, but one was encouraged by the record level of expenditures planned for 1983 by a major manufacturer in upstate New York.

Financial Panel

This month we have comments from David Jones (Aubrey Lanston & Co.), James O'Leary (U.S. Trust), and Albert Wojnilower (First Boston Corp.)*

Jones: The economy appears to be poised for a stronger-than-expected bounce-back in the early months of 1983. The recent surge in new orders provides an upward momentum that will likely be strengthened by rising consumer demand, paced by spending on autos and housing. This should, in turn, trigger the restocking of business inventories, following an excessive inventory liquidation in the final quarter of 1982. At the same time, however, there is a possibility of near-term upward pressure on interest rates, particularly longer term rates. This will stem partly from the fact

* Their views of course are personal, not institutional.

that a stronger-than-expected recovery and the related step-up in inventory accumulation will lead to an unanticipated pickup in consumer and business credit demands. More immediately, the Federal government's huge borrowing demands are likely to prove more difficult to manage, particularly if the Fed, as suggested by recent remarks by Chairman Volcker, moves to reassert monetary discipline. The expected near-term spurt in interest rates is likely to temporarily depress economic activity around mid-year. This could result in an uneven recovery pattern in 1983.

O'Leary: The fear of an ultimate heating up of inflation remains strong in the fixed-income markets and it is a powerful force toward keeping real intermediate- and longer term interest rates high. This fear is nurtured by the huge Federal deficit and the conviction that political pressures for economic expansion will cause the Fed to keep credit excessively easy for too long a time. The markets are nonetheless impressed that so far the Fed is not following the feared pattern.

We appear to be in the early stages of a general business recovery, but until there is clearer recognition that this is in fact the case, it would be appropriate for the Fed to continue cautiously to encourage lower interest rates and general business recovery. By spring or certainly by early summer, my guess is that the path of recovery will be sure enough that the authorities should begin to slow down the rate of increase of the monetary base and bank reserves. This will provide assurance that the Fed is not going to make the mistake of staying too long with an expansionary policy. Hopefully the move can be made gradually enough to avoid any run-up of short-term rates. Actually, it should help to reduce long-term rates somewhat further.

Wojnilower: Anecdotal contacts suggest, even more strongly than do the fragmentary statistics, that the economy has begun to expand. With the exception of capital goods manufacturers, attitudes among business executives have become distinctly more optimistic.

This improvement in the economic climate, coupled with official and private statements warning of the danger of re-inflation, has produced widespread market sentiment that interest rates will not decline much more if at all. This makes interest rates prone to sporadic increases until it becomes clear that the economic recovery will be anemic or, even better from the standpoint of the bond market participants, nonexistent. A collapse in oil prices would be a countervailing force that would significantly depress interest rates and, in the shorter run, also the economy. Recent contacts with individuals having exceptional high-level familiarity with the situation suggest they share the general uncertainty--and the hope, but also lack of conviction, that an orderly and sustainable agreement on a lower market price in the \$28 to \$30 per barrel range might be reached.

THIRD DISTRICT - PHILADELPHIA

Reports from the Third District reveal an overall improvement in local economic conditions in January. Area manufacturing has posted minor gains this month while industrial prices remained stable. Retail sales are doing well, encouraged by favorable weather conditions and successful promotions. In the financial sector, both business and consumer loans are up. Mortgage rates have dropped further, bringing new life to the real estate market.

Third District contacts foresee a slow but sustained recovery for area business. Upswings in both manufacturing activity and department store sales are projected by industry spokesmen, but a hint of caution is evident in their plans. Bankers are expecting further growth in retail loan demand but predict that commercial lending will flatten out by midsummer.

REAL ESTATE AND CONSTRUCTION

The turnaround in the Third District housing market has continued over the past two months. With conventional mortgage rates declining to a range of 12.50 to 13.50 percent, sales have firmed up considerably. Following an "almost normal" December, volume in January is up between 20 to 50 percent on a year-to-year basis. Most activity is still in the pre-owned home market. As a result, housing starts remain stalled and new home prices continue to drop. Brokers indicate, however, that a dip in rates below 12 percent this spring would give sales of new houses a shot in the arm.

MANUFACTURING

Third District manufacturing activity is showing marginal improvement in January, according to the most recent Business Outlook Survey. New orders posted their biggest gains since last March, and shipments registered a smaller but significant

increase. On the negative side, local factory employment plunged further this month, according to the survey, and the average workweek was pared again.

Looking ahead, respondents' prognoses for the economy remain bullish. Nearly 9 out of 10 of the executives polled in January are forecasting a business pickup within six months. New orders and shipments are expected to show major improvement by midsummer, along with factory payrolls and working hours. Light growth in inventories is still planned, but only marginal capital spending increases are likely.

The slowdown in inflation, evident for most of last year, has carried over into 1983. Survey results indicate that industrial prices in January are unchanged from December levels. Moreover, inflation is expected to remain at reduced levels for at least the next six months. Only half of this month's respondents, the lowest portion in seven years, anticipate higher prices by July for either raw materials or finished goods.

RETAIL

Department store sales in the Third District have gotten off to a flying start in 1983. Year-to-year sales gains of 15 to 18 percent are reported. Retailers attribute much of the current strength to unusually cooperative weather and across-the-board promotional activity. Moreover, current sales are being compared to depressed levels last January. Nevertheless, sales are much better than merchants had anticipated.

Retail contacts have become slightly more optimistic about future activity. Sales are projected to maintain their brisk pace into midsummer as consumer sentiment improves. By July, volume should be 5 to 6 percent over the previous year, resulting in some real dollar gains if inflation stays low.

Retail inventories have been trimmed again in January. Stock levels are now well below those of last year and are in better shape than many merchants had

expected. Retailers are still planning "conservatively", though, expecting to keep inventories tight over the next six months.

FINANCE

Third District lending activity has improved modestly since the last Redbook. Commercial loans, edging upward since December, are ahead of year-earlier levels by about 8 percent, and are pretty much in tune with bankers' expectations. On the consumer side, retail loans have grown slightly again this month. Lower interest rates and a greater willingness on the part of bankers to lend, have helped boost consumer loan volume. Area lenders foresee loan activity turning mixed in the near future. Projections of a slow recovery, increased long-term borrowing by corporations, and minimal retail and industrial stock levels point to flat activity for commercial loans over the next six months. Even with such sluggish improvements in economic conditions, however, consumers' attitudes are expected to improve, encouraging further retail loan growth.

The prime rate charged by banks in the Third District has been cut to 11.00 percent since the last Redbook. Although they expect the prime to be cut another 50 basis points by the end of the second quarter, banking contacts say the decline in interest rates is slowing because credit markets are reacting to uncertainties about the direction of Fed policy.

Deposit flows in the Third District have been significantly affected by the introduction of the Money Market Deposit Account. Heavy volume in the new account, termed a "bonanza" by one local banker, has pushed time deposit levels up as much as 30 percent over a year ago. Representatives from several large commercial banks report that 25 percent to 35 percent of MMDA deposits is new money, attracted from Money Market Funds and some of the smaller thrift institutions in the District.

FOURTH DISTRICT - CLEVELAND

Summary. Economic conditions remain dismal in the Fourth District but scattered signs suggest the bottom may be near. Unemployment is high and rising. Leading indicators and survey results suggest manufacturing activity may have reached its trough. Parts orders from the automotive industry are showing strength. Inventories probably have not yet bottomed. The steel industry remains in difficulty, but orders have improved recently. Retail sales were strong in January, but bank loan demand is mixed. Some gains are reported in construction but farmers continue in difficulty.

Labor Market Conditions. Unemployment is extremely high and continued to rise through December. The December unemployment rate was 14.5 percent (sa) in Ohio and 12.9 percent in Pennsylvania. The District's eleven major SMSAs' unemployment rates (nsa) in November ranged from 9.4 percent in Columbus to 22.5 percent in Youngstown, and averaged 3.3 percentage points above the national rate. Ohio's employment is down 11 percent from a year ago in durable goods manufacturing and 5 percent in non-durable goods manufacturing. Some scattered rehiring is reported in consumer durable goods industries and primary metals, but additional plant closings continue to be announced.

Outlook. Leading indicators suggest a further decline in economic activity in Pittsburgh but a bottoming in Cleveland. An index of leading indicators for the Pittsburgh area registered a tiny increase in November following 17 consecutive monthly declines. A similar index for the Cleveland area drifted down in October and November to a level only slightly above its April 1982 low.

Manufacturing. Manufacturing activity may have reached its trough. This bank's survey of Fourth District manufacturers shows firms expected new orders and backlogs to increase in January after having been unchanged in December. Shipments were expected to rise after having fallen in December. Inventories were expected to fall after having been unchanged in December. Employment and hours worked were expected to rise slightly after having fallen substantially in December. A survey of Cleveland area purchasing managers shows new orders are flat while production and employment are falling less rapidly than a month ago. The survey shows inventories of raw materials, supplies, and finished goods continue to decline.

Capital Goods. Parts orders from the automotive industry are showing strength but capital goods industries are generally flat, and inventories probably have bottomed. A major producer of parts for the capital equipment industry describes its inventories as "extremely lean" and "below normal even considering the low level of sales". The firm says inventories "can't be cut further". Rather than rebuild inventories in anticipation of sales, the firm plans to "scramble to fill orders as they arise". The need to scramble will be strongest in auto parts, where demand is coming back sharply, and to a lesser extent in truck parts. Heavy duty truck orders bottomed last July and have been showing some strength in the last few weeks. In contrast, no turnaround is in sight for agricultural and construction equipment. The firm does expect a turnaround next summer in orders for equipment to manufacture electronic components for personal computers and defense items, because their customers' order backlogs are rising now. The firm is building a bit of inventory now in anticipation of that summer upturn. The company will recall small numbers of employees to its auto parts plants this quarter, and expects a large increase in employment in a plant that makes defense electronics equipment.

Another supplier to capital goods producers reports orders are increasing. Orders for refrigeration equipment components are up strongly in the last two months to 40 percent above the year-ago level. Orders for gaskets and seals for transportation and non-electrical machinery are also up in the last two months. A division that supplies the machine tool industry remains flat at a very low level. Orders for automotive aftermarket and aerospace remain flat. Inventories will be increased some in the two divisions with strong orders but this will be more than offset by continued reductions of inventories in the other lines.

A major producer of bearings reports a modest upturn in orders in the last three to four weeks, most notably from the automobile industry but some also from other industries. Nevertheless the firm will continue to reduce inventories this quarter, although at a slower pace than in fourth quarter. The firm expects their employment to be flat this quarter.

Steel. The steel industry remains in great difficulty. Producers continue to operate at very low rates and to report large losses. In continuing efforts to cut costs, additional production facilities have been closed, and a major firm has imposed its second 5% cut in non-union salaries in seven months. However, signs of improvement in orders and production have surfaced in recent weeks. A large steel producer that has been operating at only 30 percent of capacity reports a late January surge in orders from the automobile and construction industries at a rate equivalent to 60 percent of operating capacity.

Retail Sales. A major department store chain reports strong January sales. The firm's real sales are up about 2 1/2 percent (quarterly rate) in the November-January fourth fiscal quarter from the third quarter. January sales apparently held at the November-December level, without seasonal

adjustment and without unusual promotions. The retailer views this development as a "fundamental upswing" in demand. The chain's inventories are lean in all lines and the ratio of inventory to sales is lower than anytime since early 1981. No inventory building is planned for first quarter but there may be an unplanned inventory runoff if their suppliers can't keep pace with sales.

Agriculture. Farmers continue in difficulty. An estimated 5% of Ohio farmers are on the brink of bankruptcy or foreclosure because of low crop prices, high interest rates, and falling land prices. Another 5% are in difficulty but are being carried by their lenders, and another 15% will be in similar difficulty if low crop prices persist this year. Two directors express concern that the proposed crop swap program would hurt livestock producers and suppliers of agricultural fertilizers, pesticides, seed, and machinery.

Construction. Some pickup in house sales and construction is reported. The stock market rise has strengthened the market for second homes. A construction company reports increased contracts and requests for bids on \$25 - 100 million size projects for local governments.

Commercial Banking. Loan demand is mixed. A large Cleveland bank reports a decrease in commercial loan demand in the last eight weeks, but lending officers expect improvement. Residential mortgage lending is showing a very small increase recently, but consumer lending is flat. Smaller banks report increases in consumer loan demand in response to lower interest rates. Banks in Cleveland have aggressively marketed the money market demand account and are having a strong response, but marketing of the Super-NOW account has not been aggressive.

FIFTH DISTRICT - RICHMOND

Overview

Once again, there was little change in Fifth District business and economic conditions over the month, although reports vary from area to area and from sector to sector. Overall, the manufacturing sector softened somewhat with new orders and order backlogs down slightly, but with inventories down significantly. On the other hand, retail sales activity has apparently firmed in recent weeks, although this improvement is not evident everywhere in the District. Reports further suggest that the housing industry, and the construction sector more generally, is continuing to make modest gains in both construction and sales. Loan demand is steady generally, but with residential mortgages doing better than other categories. Expectations are neutral to positive. If there is any consensus, it seems to be that improvement is on the way but not immediately, perhaps in the second quarter.

The Manufacturing Sector

The past several weeks have been a mixed bag for Fifth District manufacturing establishments. On balance, new orders, order backlogs, the length of the average work week, and material inventories declined slightly. Finished goods on hand and employment were down broadly while shipments rose narrowly. Inventories and current plant and equipment capacity remain well above desired levels at a number of the establishments surveyed. Prices continued generally stable, although several respondents report receiving lower prices compared to last month.

There is no clear pattern of performance by industry or area. It appears, however, that the building materials and textile sectors may have done somewhat better than average while the primary metals group

seems to have fared slightly worse.

Consumer Spending

Consumer spending appears to have strengthened in recent weeks although there are spots of continued weakness. The strength that exists appears to be primarily in general merchandise lines and, in some cases, automobiles. There is little evidence of any pickup in non-auto consumer durables.

One respondent suggested that retail activity had definitely picked up in his area, but that an unusually large portion of sales was for cash. Consumer credit activity, and particularly installment lending was not keeping pace. Another respondent remarked, however, that in his area sales continued weak and that consumer savings activity was up markedly.

Housing and Construction

The preponderance of evidence suggests that the housing recovery in the District is continuing, but that the pace has moderated in the past few weeks. It seems likely that inadequate allowance for seasonal factors may be at fault. Most reports continue to indicate the commercial and industrial sectors are much improved.

The Financial Sector

Lending activity, apart from residential mortgages, is showing few signs of life according to our respondents in the financial sector. Short-term business loans are stagnant and expected to remain that way over at least the rest of the first quarter. The same is essentially true for consumer lending except that there is some expectation of a modest improvement over the near term.

Expectations

Looking out over the next six months, most of our respondents are quite positive in their expectations. A large majority of manufacturers surveyed, for instance, expect improvement nationally, locally, and in their respective firms over that period. Retailers are less enthusiastic, but generally positive. The time frame appears critical in these expectations. Respondents in the financial sector foresee little increase in loan activity this quarter, but look forward to a consumer and mortgage lending pickup in the April-June quarter. Even then, however, there is little expectation of significant improvement in business lending.

SIXTH DISTRICT - ATLANTA

Signs of recovery in the Southeast remain sporadic, but most respondents foresee imminent improvement. Banks and thrifts are not losing funds deposited in new money market accounts despite mid-January rate reductions. The retail sector shows ongoing strength since the holidays. Sustained upward trends in construction are generating resurgence in some housing-related industries, but the clouded situation in agriculture is adversely affecting farm-related manufacturing. The upturn in tourism is localized, but industry spokesmen convey a strong conviction that broad improvement is forthcoming. A review of the economic prospects of individual southeastern states will appear in the February issue of this Bank's Economic Review.

Employment and Industry. Manufacturing evidences intermittent signs of improvement, but widespread concern over employment persists. Orders at regional carpet mills are rising substantially relative to this time last year, and executives expect an excellent second half. Textile manufacturers, however, are more cautious. Fearing a sudden reversal of economic conditions, they are lengthening hours rather than recalling laid-off workers. Wood producers report a slight increase in orders and express encouragement regarding declining interest rates, but few have plans to expand capacity unless more signs of sustained recovery appear. Inventory depletions have spurred the recall of 700 workers at an Alabama steel mill, but 1,000 remain on indefinite layoff, and a Louisiana aluminum plant will close this week, idling 550 workers. The unemployment rate in two states declined in December but rose in three others, including Florida, where it now approaches the double-digit level prevalent in every other District state except Georgia.

Conditions in the chemical industry are more uniformly negative. The industry's inventory-to-sales ratio has recently edged higher; domestic producers fear

serious encroachment of market share by low-cost, foreign imports; and federal programs to reduce farm acreage are likely to diminish demand for fertilizer even further. Fertilizer plants in Louisiana and Tennessee and phosphate mines in Florida furloughed still more workers in January.

Consumer Spending. Our most recent survey of District retailers indicates healthy conditions in this sector. Taut holiday season inventories and brisk sales, relative to last year and to the nation, are responsible for depleting stocks of merchandise. January sales were better than expected. In particular, some retailers report that resurgence in the housing market is stimulating purchases of furniture and appliances. Respondents expect slow gains in sales this quarter but an acceleration in the spring. January auto sales grew faster in the District than in the nation. Despite this performance, competitive pressures have led regional dealers to reduce auto loan rates to 5.9-6.9 percent and even as low as 2.9 percent. Although such financing requires a hefty 25-30 percent downpayment, it is reportedly stimulating floor traffic and purchases.

Construction. Mortgage activity appears lively. Realtors report a marked increase in traffic and sales during the last two months, reflecting perhaps some release of the "pent-up" demand for houses. Lower rates are attracting a greater number of first-time, middle-income buyers and are reducing activity in adjustable mortgage loans (AMLs). Demand is strongest for conventional, fixed-rate, 30-year loans, rates of which currently range from 12 3/4 to 14 percent. Consumers are seeking to "lock in" lower rates out of fear that they may rise again, and, in fact, conventional mortgage rates are edging back up. Thrift officers report that discount points on FHA and VA loans have jumped several points over the last two to three weeks, reaching as high as nine points in the last week of January. If rates stabilize at current levels, realtors and

thrift officers anticipate an overall increase of 25-30 percent in mortgage activity through the spring.

A survey of building permit departments indicates that issuances of single-family building permits continued to improve during January. Builders that "haven't been seen in a year" are now paying for permits. Still, some of the district's local economies remain in the doldrums. Columbus reports no changes in permit activity, and Chattanooga contacts observe that recovery is just beginning. Construction activity is probably most depressed in Birmingham, especially in the suburbs; some building inspectors have been laid off. Commercial permit activity remains unchanged in most of the District.

Tourism. A survey of industry representatives reveals little change in conditions other than seasonal declines during December and January. Convention travel remains soft. Lodgings spokesmen expect a sluggish first quarter but hope for national economic recovery to trigger local improvement by the second half at least. Year-end increases in air passenger traffic of major District-based carriers are more the consequence of discounted fares, which have reduced profit margins, than of incipient economic turnaround. Still, airline officials report that advance bookings are running substantially ahead of this time last year. EPCOT remains the bright spot, but its benefits have yet to extend beyond Orlando to Miami and south Florida.

Agriculture. An unusually heavy harvest volume has contributed to a downturn in Florida's citrus prices. Late December flooding in Louisiana and Mississippi did little damage to winter wheat crops. The District's winter wheat acreage is down 9 percent from last year but remains well above previous years. Participation in the new Payment-in-Kind and other acreage reduction programs is not likely to reduce production significantly because farmers tend to idle marginal, low-yield lands. With existing large stocks, the small production decline may not result in substantial price

strengthening. In January egg prices rebounded 7 percent from their 8-year low in mid-summer. Price stabilization and declining feed costs augur better returns for poultry producers this year. Recent hog price strength reflects continuing small supplies of pork. However, increases in breeding stock and farrowing intentions suggest that an expansion of supply is beginning. Lower feed costs and higher prices portend a second consecutive year of profits for hog farmers in 1983.

Finance. A survey of banks and thrifts in the District indicates little attrition in money market deposit accounts after the expiration of the original premium offers on January 13 and 14, 1983. All organizations contacted express amazement at the inertia surrounding the accounts in view of the sharp drop in rates from over 20 percent in some cases to 8½-10 percent currently. In addition, institutions polled report that consumers have little interest in the Super NOW accounts. Only half of the institutions contacted are offering the Super NOWs, and most of these are doing little or no advertising to boost them.

Panel of Economists. The majority of economists polled endorse the Federal Reserve's monetary policy of paying less regard to M1 because of technical factors. Most business economists on the panel regard M1 as an unreliable measure. Only a few state forecasters express concern that recent rates of money supply growth could rekindle inflation. Respondents hold no consensus regarding projected 1983 GNP growth although none is strongly optimistic. A narrow majority of the panel doubts that the recession reached its nadir in the fourth quarter of 1982, but most see at least some signs of recovery. Panelists most frequently cite construction and auto sales as sectors exhibiting signs of recovery, but improvement appears uneven across the District. Respondents expect Georgia, Florida, and Mississippi to surpass or at least equal the nation's rate of rebound; they expect Tennessee, Alabama, and Louisiana to recover at a slower and weaker pace.

SEVENTH DISTRICT--CHICAGO

Summary. The fourth quarter brought further declines in economic activity in the Seventh District, but some faintly encouraging developments began late in 1982 and have continued in January. The overall decline in employment appears to be levelling off and some callbacks of laid-off workers have been announced, principally in the automotive sector. Steel orders have improved modestly, from a record low. Residential activity has been improving, from a very depressed level, and the uptrend is expected to continue. Scattered defense orders are helping some hard-pressed companies. Inventory liquidation appears to be coming to an end with some rebuilding in prospect. Discounted prices are firming up in some wholesale markets. Finally, unusually mild winter weather has boosted morale, held down heating bills, and permitted pouring of foundations for new housing in January--a most unusual development.

On the negative side, the record slump in producer goods demand is still underway with no recovery in sight. An unusual number of business activities are being liquidated--factories, retail stores, and trucking operations. New hiring remains at a very low rate. State and local governments are grappling with unprecedented budget deficits. Agriculture, plagued with low prices and a huge overhang of crops, faces another bleak year, but PIK introduces a more optimistic outlook for 1984.

Mild Weather. Through mid-January, heating degree days in major District centers have been about 20 percent below last year and 12 percent below normal (the average for 1940-70). Milder weather has about offset increases in natural gas and electricity prices for most users. Nevertheless, many households are delinquent on utility bills, and there are strong pressures to

provide subsidies and/or stop shutoffs of service. The absence of the extreme cold and storms of most recent years may cause some seasonally-adjusted data to appear strong.

Inflation. During the past year, wholesale prices have been discounted over a broad range of items, heavily in some cases such as steel. Many producers must raise prices if they are to remain in business. Despite some concessions, labor costs continue to rise. Productivity has been adversely affected by short production runs. Gasoline and heating oil prices continue to soften, but some wholesale prices are beginning to "firm up", most notably residential building materials. Because most list prices have remained stable, it is probable that neither the discounting of prices nor the recent firming will be fully reflected in the price indexes.

Employment. In late 1982 total payroll employment was the lowest since 1975 in Illinois, Indiana, and Iowa, and the lowest since 1971 in Michigan. Manufacturing employment was the lowest since 1940 in Illinois and Michigan, and the lowest since 1949 in Indiana. The decline in employment appears to have slowed, and there have been scattered callbacks of laid-off workers. Many plants will stretch work weeks rather than hire workers if demand increases. Reductions in force are still being announced in usually stable sectors, such as public utilities, hospitals, insurance, and state/local government. Companies that have drastically cut overhead staff to lower breakeven points will be reluctant to rehire, even if work pressures build up.

Steel. Orders for steel have increased somewhat in the past several weeks, mainly from the auto sector. Inventories of steel users are low and their operations depend on very short delivery schedules. Steel mill operating rates have improved, but remain below breakeven points.

Motor Vehicles. First-quarter passenger car production schedules are one-third above last year, and light truck schedules are up moderately. Orders to suppliers have increased--steel, engines, tires, moldings, and fasteners etc. Demand for full-sized, fully-equipped models has increased to the point that some models are in short supply, but production must be limited to satisfy CAFE ratios.

Capital Goods. It looks like a bad year for machinery and equipment of virtually all types, for many the worst since the 1930s. Operating rates are so low at some plants that work cannot be scheduled efficiently. There is a large supply of finished mobile equipment for agriculture, construction, and transportation, and much used equipment is idle and available for purchase. Some diversified capital goods producers have shrunk operations to small fractions of peak levels and plants are still being closed and dismantled. Some historically strong companies that have defaulted on debts hope for a pickup in demand to avoid formal bankruptcy.

Construction. Home building has been trending upward for several months and the rise is expected to continue. Favorable weather is permitting construction to proceed at an unusual pace. There is no significant inventory of unsold units. Nonresidential construction will be down significantly this year.

Consumer Purchases. Auto sales have increased in the past two months. Partly this reflects more favorable finance terms, but dealers say that the underlying tone of the market has improved. General merchandise sales, especially apparel, have been hurt by unseasonably warm weather. Nevertheless, there was little overhang of goods at retail because merchants had been ordering very cautiously for the past six months. A life insurance

company reports that one-third of the funds withdrawn recently by policy holders have been used to pay living expenses.

Government. All five district states have serious budget problems. Michigan, particularly, is in desperate straits. Revenues have fallen below expectations, federal grants have been reduced, income support burdens have increased, and various essential public works projects are scheduled. In some states with constitutions forbidding deficits, accounting subterfuges have hidden the extent of the problem. Income and sales taxes have been, or will be, raised. Scheduled property tax relief may be postponed. State grants for municipal services, including schools, must be slashed. With municipal unions attempting to increase or maintain salary scales, further personnel cuts are probable. In summary, the state and local sector will be a drag on any recovery in the private economy in 1983.

Agriculture. Conditions are still very depressed in agriculture. However, the recently announced "payment in kind" (PIK) program provides optimism for the longer-term perspective. A high level of participation in PIK and other programs limiting crop acreage is expected. With acreage reduced substantially, marked declines will occur in farm purchases of seeds, fuel, fertilizer, and pesticides. The price response this year to reduced acreage may be limited, but with far more farmers eligible for price support benefits, cash income in 1984 is expected to improve considerably.

District farmland values continued to erode in the fourth quarter. Since the downturn began in the fall of 1981, values have declined nearly a fifth to the levels of the late 1970s. Farm real estate transactions remain at a low volume.

EIGHTH DISTRICT - ST. LOUIS

Economic activity in the Eighth District showed signs of improvement during December and January. Consumer spending increased, continuing a trend that began last fall. Industrial production and employment changed little on balance from earlier depressed levels, but a few manufacturing firms reported that orders began to strengthen around the turn of the year. Some businessmen have become more optimistic about economic developments in 1983, noting the recent improvement in sales, an accompanying decline in inventories, greater after-tax incomes, lower interest rates and more stable prices.

Within the District, economic activity has varied. According to Southwestern Bell's index (based on measures of employment, trade and construction), business activity in Arkansas recently was 4.3 percent below year-ago levels, while in Missouri activity changed only slightly. In Arkansas, a relatively large share of the work force is engaged in manufacturing, which was severely affected by the recession, but in Missouri employment is more diversified in trade, transportation, public utilities, financial services and government.

Automobile sales in the District have been relatively strong. Six of eight dealers reported sales improvement in December and early January. At two large dealers, sales in December were the best for that month in over 10 years, with year-over-year jumps of 27 and 25 percent. Both the larger American cars and smaller foreign cars have been moving well, and

one dealer reported that used car sales were particularly vigorous. Two dealers added salesmen and repairmen to handle the increased volume.

Sales in the District also increased for both new and existing homes during December and early January, according to respondents. One realtor noted that, once a house sells, another sale is stimulated, since the seller then has funds and needs a place to live. Sales of new homes in the St. Louis area were 66 percent higher in early January than in the like period last year, but were still about half of normal, according to the St. Louis Homebuilders Association.

Sales at major department stores in the Eighth District were 6.2 percent larger in December than in December 1981, a gain of about 2.5 percent after adjusting for merchandise price increases. Some smaller clothing stores and outlets specializing in automobile and tractor parts experienced even larger year-over-year gains. In the first four weeks after Christmas, sales at major department stores, aided by unseasonably good weather, were about 9 percent higher than during the corresponding year-earlier period. Two restaurant chains also reported relatively large receipts in December and early January.

Performance in the industrial sector has been mixed. Firms producing industrial equipment, chemicals, wood products and metals had slightly lower orders, production and shipments in December and early January than in the fall. On the other hand, firms producing consumer durables, defense goods, shoes, food, synthetic fibers, paper and boxes noted an increase in activity. Orders and shipments rose faster than

production at a number of firms, and inventories declined. Most capital spending plans were unchanged in December and January, but a few companies stretched out completion dates. Federal Express set records in December for the number of packages handled. A company dealing in motivational programs for businesses reported an increase in new accounts, usually an indicator that business will improve.

The efficiency of many industrial firms improved during the recession, permitting them to remain profitable at relatively low levels of operation. Break-even points were reduced by pruning excess personnel, closing marginal facilities, liquidating unprofitable lines and applying stringent cost controls. As sales pick up, profits are expected to rise rapidly.

At most businesses in the District, employment was reported to be virtually unchanged since early December. A few firms, however, continued to trim staffs through attrition. In addition, International Paper laid off 200 woodhaulers, a steel foundry idled 500 workers, and Pyro Energy laid off 250 coal miners. On the other hand, International Harvester recalled 800 workers at a foundry in Louisville, American Greeting Card Co. hired 300 workers in Arkansas, and Carrier Air Conditioner brought back 700 employees in the Memphis area. Chrysler and General Motors announced plans to hire 3,200 and 900 employees, respectively, in the St. Louis area. According to a private consulting group, over two-thirds of the firms surveyed paid a holiday or year-end bonus to employees even though in many cases profits had declined.

NINTH DISTRICT - MINNEAPOLIS

Signs of recovery continue to appear in the Ninth District. In December and January, consumers increased their spending on homes, autos, and general merchandise and were willing to spend on winter recreation. This spending sustained the revival in lumbering and in some manufacturing industries. In addition, good prospects are now reported for some district computer manufacturers, and other manufacturers seem to think the worst is behind them. Unfortunately, significant parts of the district economy have yet to get any relief. In January, manufacturers supplying industrial goods still were cutting back operations, and metal mining continued to totter from another round of layoffs and shutdowns. The Administration's new farm program might bolster farm income in the future, but at year-end it was reportedly down from a year earlier in most of the district. Furthermore, bank lending remained weak in January, which indicates that, overall, the district economy has not yet begun to recover.

Consumer Spending

The most convincing signs of recovery in our last Redbook report were pickups in home and auto sales, and these sales have continued to expand. According to the Minneapolis Board of Realtors, home sales in Minneapolis and its suburbs were up 16 percent from a year earlier in the fourth quarter and remained better than a year ago in early January. Likewise, regional sales managers for the nation's two largest auto manufacturers report that their December sales were up around 35 percent from a year earlier and their early January sales were greater than a year ago. This Bank's directors confirm

these sales gains; they say that home and auto sales in their communities have been good recently.

General merchandise sales also have continued to improve. After sales revived in October, a post-Thanksgiving slump threatened the recovery, and retailers hoped that a late December sales spurt would let them better their 1981 holiday sales. They were not disappointed. Two large Minneapolis-St. Paul department stores report that their December sales were up about 7 percent from a year earlier. In addition, both retailers are pleased with their early January sales. According to a Montana director, sales of general merchandise have been good recently in his state too.

Consumers have been spending on winter recreation as well. In Montana, where snow arrived early, the last really good ski season was in 1974-75, and according to the Montana Department of Tourism, the 1982-83 season should top it. In Minnesota, northwestern Wisconsin, and the Upper Peninsula of Michigan, snow didn't arrive in many areas until late December, so the ski season got off to a late start. But where there is snow, ski area operators report brisk business in January, and they expect it to remain good. In late February, for example, the Birkebeiner cross-country ski race in northwestern Wisconsin is expected to draw a record 8,000 participants, and all available lodging within two hours of the race site is already reserved.

Industrial Activity

Our last Redbook report noted that the pickup in consumer spending had just started to carry over into the industrial sector, and this transfer has continued. Reflecting recent increases in home sales, several lumber mills have either resumed or stepped up their operations, a Montana labor

market analyst reports. And large manufacturers of residential temperature controls and windows report that their recent orders have been about 15 percent ahead of a year earlier.

Prospects appear to be good for some other district manufacturers too. Due primarily to increases in defense orders, a large Minneapolis-St. Paul computer manufacturer plans to hire an additional 1,200 people this year. Due to increases in commercial orders, another computer manufacturer plans to expand its work force 8 to 10 percent this year. The district's largest computer manufacturer, whose sales of computer accessories suffered last year, reports that a turnaround looks near: its sales have stopped declining but have not yet begun to increase. A large manufacturer of housewares and another of adhesives and packaging materials voice similar views.

District manufacturers supplying industrial goods, however, report declining business. A Minneapolis-St. Paul manufacturer of industrial filters says business has been soft lately, and this firm has continued to lay off workers. A southern Minnesota manufacturer of electric generators laid off 71 workers in January. In Michigan's Upper Peninsula, a manufacturer of heavy construction equipment, which once employed 2,000 workers, laid off its remaining 200 workers when it permanently shut down in January.

Recent developments in metal mining have not been hopeful either. Our last Redbook report noted that two iron mining companies were planning to recall workers in early 1983, but these recalls have been largely offset by recent layoffs. The closing of Bethlehem Steel's Lackawanna, New York, facilities resulted in 900 Minnesota iron miners being laid off for eleven weeks. In the Upper Peninsula of Michigan, another 700 iron miners were laid off in

January. Also, the Upper Peninsula's one large copper mine remained shut down, and the Anaconda Company announced that it would permanently cease all copper mining in Montana by June 30, which will idle 700 workers.

Agricultural Conditions

The recovery has continued to evade the farm sector too. Of the bankers responding to our late December Agricultural Credit Conditions Survey, 81 percent said that farm income in their communities was less than a year earlier in the fourth quarter of 1982.

The new payment-in-kind (PIK) program, however, should bring some relief to district farmers. Much of the farm income decline stems from large stocks of farm commodities depressing prices. In Minnesota, for example, corn stocks currently are at a record level and are up 27 percent from a year ago. The PIK program is designed to reduce stocks by decreasing plantings and paying farmers in commodities. The program may not raise prices much until 1984, but the grain that farmers will receive and the production expenses they will save should boost their 1983 income. PIK, however, could reduce farmers' purchases of seed, fertilizer, and other production inputs this year.

The more farmers participate in it, the more the PIK program will reduce stocks and eventually raise prices, and participation in the district may be quite high. In Minnesota's second largest corn-producing county, for example, officials estimate that farmers controlling 80 to 90 percent of the corn acreage will be enrolled in the PIK program. This is about twice the participation in last year's program, which was only 43 percent.

Financial Conditions

Although signs of recovery continue to appear, bank lending has yet to reflect any overall recovery in the district economy. In January, bank loans at both city and country banks were essentially unchanged from their weak December levels. At city banks, this weakness stemmed from the slack in overall business activity, and at country banks it resulted from poor agricultural conditions. Forty-four percent of the bankers responding to our latest Agricultural Credit Conditions Survey considered their year-end loan-to-deposit ratio low. Furthermore, much of the recent loan demand at rural banks has not been for new credit, but rather to refinance debt that farmers can't repay. Seventy-eight percent of the survey's respondents indicated that demand for farm debt refinancing was greater than normal in the fourth quarter.

TENTH DISTRICT—KANSAS CITY

Overview. Business firms in the Tenth District are expecting a slow recovery to get underway during the second or third quarter of 1983. Recent stable prices are expected to rise slightly as 1983 moves along. Inventories are generally lean and are likely to remain so in the near future. Farmers and agricultural lenders are somewhat more optimistic about conditions in the agricultural sector, due partly to the expected response to the newly announced farm program. Loan demand at commercial banks is generally flat, while deposit growth is up because of strong growth in the new money market deposit accounts.

Retail Trade. All respondents indicate that nominal sales for 1982 as a whole were slightly higher (5 percent or less) than those in 1981. Sales in the final quarter of 1982 were between 5 and 10 percent higher than a year earlier. The strength in retail sales has come mainly in soft goods, with big-ticket items still very weak. Prices, which were stable during the last three months of 1982, are expected to remain stable or rise slightly in 1983. Retailers seem to be generally satisfied with the low level of their inventories. They expect sales to be sluggish in the first half of 1983 and to improve slowly after that.

Purchasing Agents. All purchasing agents report that prices of a wide range of materials inputs (e.g., steel, aluminum, rubber, plastics) have stabilized over the past three months. Agents expect prices to remain stable, inputs to remain accessible, and lead times to remain short during the first quarter of 1983. With the economy expected to pick up in the second quarter, firms anticipate suppliers may reestablish previously rescinded price hikes

and eliminate current discounts. They also anticipate some spot shortages and longer lead times. Thus far, however, purchasing agents are not expanding inventories to accommodate the increase in demand they foresee.

Automobile Dealers. Automobile dealers are guardedly optimistic about the chance for increases in auto sales during the next few months. November 1982 was reported as a very good month, but sales were flat to only slightly higher in December 1982. Despite trim inventory levels and lower interest rates, there has been no rush to greatly expand stocks. Some dealers remain fearful of the potential adverse impact on interest rates of looming large federal deficits.

Agriculture. Cattle feeders are currently doing well and making a profit, according to Tenth District bankers. Winter wheat conditions in the southern part of the District are poor-to-fair, and little grazing of cattle is reported. Bankers and farm borrowers are enthusiastic about the 1983 Payment-In-Kind (PIK) program, with high participation anticipated. District bankers report that some nonfarm rural businesses view the PIK program as just another government subsidy, and are concerned about its negative impact on demand for the products and services they sell to farmers. Others look forward to an improved farm economy as a means to helping their own financial situation. Loan paydowns by District farmers on their agricultural production loans have generally been disappointing. Bankers in some areas of the District report an 80 percent loan rollover rate with 60 percent of the farm borrowers making small and/or slow paydowns. Many farmers have sold their crops at prices below the cost of production to generate cash flow, rather than holding the crop in anticipation of improved prices. Although 1983 has not yet revealed evidence

of improved conditions for the agricultural sector, a more optimistic mood by farmers and lenders is beginning to build.

Banking. Loan demand is reported to be generally flat in the Tenth District. Demand for real estate loans is up slightly, but demand for consumer, agricultural, and commercial and industrial loans is flat. Virtually all respondents indicate that loan quality is stable, although one banker reports a rising number of defaults on energy-related loans.

Prime rates charged by the banks surveyed vary from 11 to 14 percent, with most falling in the 11-12 percent range. Rates have fallen around 50 basis points since last month. Roughly half of the bankers surveyed expect a further decline of 50 basis points in coming weeks while the other half expect no change.

Deposit growth is up at Tenth District banks, due in large part to strong growth of the new money market deposit accounts. Demand deposits are steady to slightly up, while conventional NOW accounts are steady to slightly down. Large CD's and money market and small saver certificates are down somewhat.

All of the banks surveyed are offering the new money market deposit account and the new Super-NOW account. Public response to the former is characterized as strong, while response to the latter is characterized as weak. Three explanations are given for the apathetic response to the Super-NOW account: weak promotional campaigns, consumer confusion, and competitive superiority of the money market deposit account (higher yield, lower service charge). Bankers report that as much as 60 percent of the funds flowing into money market deposit accounts are coming from outside their institutions. Preliminary data suggest a much lower percentage for Super-NOW accounts.

ELEVENTH DISTRICT--DALLAS

Overall, the Eleventh District has shown little change since the last Redbook, but some movements have occurred. Growth in residential construction, auto sales, defense contracting, and electronics equipment manufacture has continued, as have declines in office building, and total manufacturing. Oil and gas drilling resumed its decline after rising in November and December. Texas' unemployment rate remains high for Texas, but well below that of the nation.

In residential construction, builders are increasing inventories in anticipation of strong Spring demand. More permits for single family homes were let in the fourth quarter of 1982 than in any comparable period since the late 1970's. But builders fear an increase in interest rates later this year. Apartment construction is climbing in some areas but is slow in others.

Domestic auto dealers report that December's healthy sales pace is holding and they expect it to continue into the second quarter. Inventories stand at desired levels and traffic is good for new domestic autos. Sales of imports and used cars remain low.

Retailers are cautious for Spring, budgeting to meet or fall below last year's unspectacular sales volumes. Inventories remain on plan, but profits are below expectations because of forced increases in promotions and discounts. Sales of consumer durables are flat but expected to rise in the wake of housing market growth. Credit sales as a proportion of total sales are above a year earlier.

S&L's attribute their increases in total deposits to the Money Market Deposit Account (MMDA). Some of these deposits are clearly

temporary, though, attracted by high introductory rates. S&L rates on MMDA and Super NOW accounts are 1.5 to 2.0 percentage points above comparable commercial bank rates. S&L's plan to invest heavily in residential and commercial real estate, chiefly in Texas. Demand remains strong for residential mortgage loans and interim construction financing for residential developments.

All deposit categories at commercial banks showed strong increases in December, but most of the growth was only seasonal. Seasonally adjusted demand deposits and large time deposits actually declined, but their fall was more than offset by a whopping increase in savings deposits. Total loans grew slightly thanks, largely, to a big jump in real estate loans. Loans to business fell.

The Texas drilling rig count showed a normal seasonal decline in January, following increases in the fourth quarter. An anticipated February decline won't be merely seasonal, though, but will reflect the slow pace of economic recovery and the uncertain outlook for oil prices.

Manufacturing production continues to decline, but there are some signs of recovery. A General Motors assembly plant recalled 600 workers. Sales of some defense and some consumer electronics are doing well, although demand for industrial electronics remains depressed. Production of defense electronics should increase on schedule as manufacturers here expect to remain unaffected by defense cuts. Capacity utilization at steel mills is low and output levels unprofitable. Sales of construction steel are level and respondents expect declines later this year. Suppliers to the drilling industry report a slight uptick in drill bit sales in January, but sales of other drilling-related products remain low and inventories are

excessive. Export sales are a source of strength because drilling has declined less abroad than in the United States.

The Texas labor market changed little in December. At 8 percent, the state's unemployment rate hovered in an area where it has remained for several months. Nonagricultural employment did increase slightly and retail trade, oil and gas extraction, and lumber and wood products were among the stronger gainers.

According to a survey of Eleventh District agricultural bankers, about twice the number of farmers who normally go out of business in the second half of a year went out of business in the second half of 1982. This departure rate is expected to increase still more in the next three months, as farm loans mature.

TWELFTH DISTRICT -- SAN FRANCISCO

The economy of the Twelfth District remains depressed, with unemployment rates above the national average, but for the first time in several months there are a few signs of cautious optimism. Automobile and home sales are up, for example, and there are reports of increased retail sales activity. The overall picture remains bleak, however, with the region's major sectors still deeply depressed. Depository institutions are actively pursuing their newly acquired deposit-taking powers and aggressively promoting the accounts with above-market deposit rates and special bonuses. These developments have increased overall costs of funds by between 25 and 100 basis points according to a special survey by this Bank.

Consumer Spending

Retail sales appear to be picking up slightly in some areas, even after accounting for inflation. In California's Central Valley, for example, one sales report suggested a 9 percent increase over the year, and in the Los Angeles area, sales in November, December, and the first week of January were up 8, 7, and 13 percent respectively over the year before. Retail sales of franchise operations are generally reported to be up slightly or flat, and there are some reports of active automobile sales. The tempo of retail activity varies considerably, however, with the Pacific Northwest generally reporting the most persistent weakness in consumer enthusiasm.

Manufacturing and Mining

The picture in this sector continues to be dominated by the extremely weak lumber industry. Although lumber inventories have declined with

concomitant firming of lumber and plywood prices in December, there has been no general surge in demand as would be required to rescue an industry in deep recession. (The Oregon State Homebuilders Association reported the lowest number of housing starts in 1982 in their history.) Mining remains weak--particularly copper and coal--but now that silver prices have gone above \$11 an ounce some of the mines in North Idaho are reopening. Aerospace presents a mixed picture, with relatively strong reports from Southern California, but with the continued weakness of Boeing's commercial aircraft business retarding this activity in the state of Washington. Despite offsetting growth in military-related employment, observers expect Boeing employment to be down by a net of 8,000 workers for 1983. The electronics industry in California and the Pacific Northwest remains weakened by foreign competition and disappointing domestic demand growth. Primary metals manufacture and fabrication also continue to be weak; the recession in the aluminum industry has been a major factor in the woes of the Pacific Northwest.

Construction and Real Estate

Recent declines in mortgage interest rates have spurred increases in construction in many parts of the District. In southern Idaho, for example, residential starts in December were up 75 percent over 1981, and non-residential construction valuation was up 78 percent over the same period. The substantial increase in FHA mortgage applications throughout the District supports the prospect of strong recovery if rates stay down. In certain areas, however, an overhang of unsold inventory has blunted the effect of recent mortgage rate improvements. This is particularly true of Southern California where, despite increased sales activity, residential construction remains depressed and the inventory is dissipating slowly.

Agriculture

Generally, agriculture has been troubled by both weak prices and weather-related crop damage. In Idaho, where agriculture is the major economic activity, weak cattle prices and a frost-damaged potato crop have caused widespread difficulty; in the latter case, this is the reverse of the expectations earlier this year when a bumper potato crop was anticipated. In California, cold and wet weather damaged raisin grape and almond crops. The estimated loss is between \$150 and \$300 million. Lettuce and fruit and nut tree growers have benefitted, though, as the weather has permitted delayed harvesting of desert lettuce crops and the cold will increase bud-setting on the fruit and nut trees.

Financial Institutions

The major developments in the District's financial environment have been the introduction of the Money Market Deposit Accounts (MMDAs) and the so-called "Super-NOW" accounts. A special survey by this Reserve Bank finds that the MMDA has been marketed very aggressively with above-market rates and one-time bonuses. Estimates of the amount of "new" money attracted to these instruments varies from 15 percent to almost 50 percent, while estimates of the effect on the overall cost of funds varies from 25 basis points to more than 100 basis points. All respondents agreed, however, that by comparison with the MMDA, the "Super NOW" account has been much less popular. Mortgage rates in the District have fallen considerably and are now in the 12.75 to 13.50 percent range, with the standard fixed-rate 30-year mortgage by far the most popular instrument in most areas.